

Internal Revenue Service

Appeals Office

8701 S. Gessner, Suite 750, MC 8000 H-AL
Houston, TX 77074

Number: 201344011

Release Date: 11/1/2013

Date: August 7, 2013

**ORG-
ADDRESS****Certified Mail****Department of the Treasury**

Employer Identification Number:

EIN

Person to Contact:

Employee ID Number:

Tel:

Fax:

Tax Period(s) Ended:**UIL: 512.09-03**

Dear

This is a final determination that you do not qualify for exemption from Federal income tax under Internal Revenue Code (the "Code") section 501(a) as an organization described in Code section 501(c)(7).

The revocation of your exempt status was made for the following reason(s):

Non-member income consistently exceeded the 15 percent limitation of total income, in the two years under examination. Nonmember income sources consisted of the following activities with the general public: charitable gaming, sales of ink markers, and sales of food and drink. Hence revocation of your exempt status is proposed effective July 1, 20 . Additionally you do not qualify for exemption under section 501(c)(4) of the Internal Revenue Code because the organization is not engaged primarily in social welfare activities within the meaning of the statute.

You are required to file Federal income tax returns on Forms 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

Please show your employer identification number on all returns you file and in all correspondence with Internal Revenue Service.

We will make this letter and the proposed adverse determination letter available for public inspection under Code section 6110 after deleting certain identifying information. We have provided to you, in a separate mailing, Notice 437, *Notice of Intention to Disclose*. Please review the Notice 437 and the documents attached that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,

Timothy D. Jarvis
Acting Appeals Team Manager

cc: POA

Enclosure: Publication 892 and/or 556

Internal Revenue Service
Tax Exempt and Government Entities
Division Exempt Organizations: Examinations
1122 Town & Country Commons Drive

Department of the Treasury

Chesterfield, MO 63317

Date: **APR 4 2012**

Taxpayer Identification Number:
Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

ORG

ADDRESS

Certified Mail — Return Receipt

Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter revoking your exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s)

shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018
Report of Examination
Envelope

Form 886A	Department of the Treasury - Internal Revenue Service Unagreed Revocation with Alternative Issue	Schedule No. or Exhibit 1, Exhibit 2 Form 1120 Form 990-T
Name of Taxpayer ORG EIN		Year Period Ended June 30, 20XX and June 30, 20XX

LEGEND

ORG - Organization name EIN - ein XX - Date Address - address
City - city State - state Festival - festival CO-1 & CO-2 - 1st &
2nd COMPANIES

ISSUE

1. Whether ORG may continue to qualify for exemption under IRC 501(c) (7) when its non-member income consistently exceeds the % limitation of total income?
2. Whether ORG may continue to qualify for exemption under IRC Section 501(c)(7) when its sources of income are from conducting bingo activities with the general public, sales of ink markers, food and drinks to the general public?
3. Whether ORG is no longer exempt under Section 501(c) (7) is liable for filing Form 1120?

FACTS

On June 30, 19XX, the Internal Revenue Service issued a determination letter recognizing ORG as being exempt under section 501(c) (7) under group exemption for ORG in City, State, EIN EIN. The ORG chapter of ORG was granted exemption under the group ruling in 19XX as a 501(c)(7), clubs organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

ORG college fraternity is incorporated in the State of State. Their Constitution and By-Laws, Article II hold that the purpose for which ORG was formed is:

- to maintain, manage and administer real estate situated at Address, City, State
- to be responsible for all the fund raising efforts to accomplish this purpose
- to provide scholarships to undergraduate members
- to fund other activities that will strengthen the chapter and/or further the purpose of the ORG national fraternity

ORG activities include associate member education, quarterly meetings, a crawfish boil, a homecoming event, a formal dinner party/dance (where the officers are elected), and the Festival.

The Alumni Association oversees the associate member education program by attending weekly

meetings, providing lectures and workshops on issues to encourage growth of the chapter, and by providing an associate member education program, known as " ". All of these functions are funded primarily by the annual dues paid to the Alumni Association, with the exception of the Festival and the bingo.

Form 886A	Department of the Treasury - Internal Revenue Service Unagreed Revocation with Alternative Issue	Schedule No. or Exhibit 1, Exhibit 2 Form 1120 Form 990-T Year Period Ended June 30, 20XX and June 30, 20XX
Name of Taxpayer ORG EIN		

The primary non-member fund-raising activity of ORG is charitable bingo. The proceeds from the bingo are used to make donations to other charitable organizations.

Income

The ORG fraternal residence has a total of 14 rooms available for students to rent in the house for \$ per semester for four semesters. ORG charges \$ for dues for the undergraduate members. ORG Alumni Association pays annual dues of \$ and oversees the finances of the house. The member income for the period ending June 30, 20XX is \$, with associated total house expenses for the period of \$.

The Festival occurs one time per year in State, and many of the students from the University use this to raise funds. The students rent a booth; make food to sell; and distribute information about their college fraternity upon request. The income for this activity for fiscal year ending June 30, 20XX was \$ and \$\$ for fiscal year ending June 30, 20XX.

The members of ORG also conduct bingo games (traditional bingo and video bingo), at the CO-1 in City, State. The CO-1 is an unrelated for-profit organization. The State of State allows non-profit organizations to rent a portion of the facility for conducting charitable bingo. ORG rents space at the CO-1 to conduct the bingo games. According to the gaming laws for State, exempt organizations are required to participate in 15 sessions per month at a minimum.

The bingo activity is the majority of ORG's income and expenses. A member of ORG conducts the bingo games, sells ink markers, bingo cards, food and drinks. A distributor oversees the operations of the bingo games and does the pay out for the bingo prizes. ORG received % of the video bingo proceeds from this activity. The number of people attending the bingo exceeds the number of members of ORG.

In a separate room, there are video bingo machines that resemble slot machines. The same distributor pays out the winnings on these machines. At the end of the session, a member from ORG counts the gaming proceeds with the distributor, prepares the deposit, and takes the deposit to the bank. The proceeds from the bingo are kept in a separate bank account from the operating account for ORG, per the State of State.

Form 886A	Department of the Treasury - Internal Revenue Service Unagreed Revocation with Alternative Issue	Schedule No. or Exhibit 1, Exhibit 2 Form 1120 Form 990 Year Paid Filed
Name of Taxpayer ORG EIN		June 30, 20XX June 30, 20XX

LAW

Section 501(c) (7) Law

IRC §501(c)(7) provides the following definition; clubs organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Section 501(c)(7) was amended in 1976 by Private Letter Ruling 94-568 to provide that section 501(c)(7) organizations could receive some outside income, including investment income, without losing their exempt status. Prior to passage of this law in 1976, section 501(c) (7) of the Code provided exemption for social clubs organized exclusively for pleasure, recreation, and other non-profitable purposes. Private Letter Ruling 94-568 substitutes the work "substantially" for "exclusively".

Both Senate and the House Committee Reports show that this wording change was intended to make it clear that social clubs may receive outside income, without losing their exempt status. However, the Committee reports also specified clearly defined limits on this outside income, which if exceeded then invoke the application of a facts and circumstances test. The laws allows social clubs to receive up to % of their gross receipts, including investment income, from sources outside their membership without losing their exempt status. Within this %, no more than % of their gross receipts may be derived from non-member use of club facilities and/or services. (S. Report No. 94-1318 (1976), 2d Sess., 1976-1 C.B. 597; H. Report No. 94-1353, to accompany H. Report 1144 (Public Law 94-568, 3-4, 8 (1976)).

The percentage of nonmember income allowed for a section 501(c) (7) is % and not more than % of the gross receipts derived from the use of the fraternity's facilities or services by the general public.

Revenue Procedure 71-17, 1971-1 C.B. 683, provides guidelines for determining the effect of gross receipts derived from nonmember use of a social club's facilities on the club's exemption under section 501(c)(7) of the Code. Rev. Proc. 71-17 sets as an audit standard that if the annual gross receipts from the general public for use of a club's facilities are five percent or less of the club's total gross receipts, the Service will consider that the existence of gross receipts from the general public does not indicate a nonexempt purpose. If the annual gross receipts from the general public exceed this audit standard, this will be considered as one factor among all facts and circumstances examined to determine whether there is a nonexempt purpose.

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not meet the purposes of operating on a nonprofit basis for the pleasure and recreation of its members and their guests.

Jockey Club v. Helvering, 76 F2d 597, 598 (2d Cir 1935) states that "the court in determining whether income derived from nonmembers inured to the benefit of members, held that a club may make a profit on occasion but, taken by and large, the returns from outsiders should do no more than reimburse the club for its costs. However, if upon computation they are such a source of income over a substantial period of time so as to justify the conclusion that it is deliberate, such net earning inure to the benefit of the members, though they are not distributed.

Polish American Club, Inc. v. Commissioner, 33 T.C.M. (CCH) 925 (1974) T.C. Memo. 1974-207 held that the statutes and regulations require that exempt social clubs be organized and operated exclusively for pleasure, recreation and other non-profitable purposes. The case law has modified this requirement by allowing social clubs to qualify for exemption under section 501(c) (7) when its outside profits were: (1) strictly incidental to club activities, not as a result of an outside business; and (2) either negligible or nonrecurring. However, when the outside income is both substantial and recurring the statutory requirements are not satisfied and the social club is not exempt from tax.

The Minnequa University Club v. Commissioner, 30 TCM (CCH) 1305 — Tax Court 1971 held that the "exclusively * * * non-profitable" operation requirement has been tempered somewhat by regulations and case law. The cases clearly permit generation of some income from nonmember sources so long as the activity generating such income is both substantial and recurring, the statutory requirements are obviously not met and loss of tax-exempt status must result.

IRC §513(f) defines certain bingo games as not meeting the definition of an unrelated trade or business. Certain bingo games include any games of bingo, where a wager is placed, and a winner is determined, and a distribution of a prize is made in the presence of all persons placing a wager.

IRC §512(a) (3) provides special rules used in determining unrelated business taxable income for certain organizations, including those exempt under IRC §501(c) (7). For covered organizations, the term "unrelated business taxable income" means gross income (excluding "exempt function income" as defined in IRC §512(a) (3) (B) less allowable deductions and with certain modifications. In general, exempt function income means income from payments by members as consideration for the organization providing members, their dependents, or guests, goods, facilities, or services furthering exempt purposes. Exempt function income also includes all income (except income from unrelated trade or business computed under IRC §512(a) (1)) which is set aside for a purpose specified in IRC §170(c) (4).

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Name of Taxpayer ORG EIN		Year/Period Ended June 30, 20XX and June 30, 20XX

Section 501(c) (4) Law

Section 501(c) (4) of the Internal Revenue Code grants exemption to:

"Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local association of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes."

The regulations describe the promotion of social welfare as promoting in some way the common good and general welfare of the people of the community, such as bringing about civic betterment and social improvements.

Erie Endowment v. United States, 62-1 U.S.T.C. 9173, the court defined "civic" as pertaining to a city or citizen; relating to the community. The court provides that a civic league or organization embodies the idea of citizens of a community cooperating to promote the common good and general welfare of people of the community. *Erie Endowment v. United States*, 316 F.2d 151 (1063) affirming the conclusion of the District Court, held that the concept of social welfare suggests benefits affecting a whole community of people rather than a private group of citizens. It held that a corporation formed to carry out the purposes of an irrevocable inter vivos trust does not qualify under § 501(c) (4) as a civic organization because it was not a community movement designed to accomplish community ends.

People's Educational Camp Society, Inc. v Commissioner, 331 F.2d 923(1964) held in exceptional cases, an organization whose services are made available solely to its members will, by the nature of the services and the group receiving them, be considered as benefiting the community as a whole. In such exceptional cases, it must be clearly established that making the service available to the particular group benefits the community as a whole.

Revenue Ruling 68-46, 1968-1 C.B., 260 held although an organization carried on veterans' programs and other benevolent, patriotic, and civic activities, its business activities involving rental of its office building and providing food and bar catering services exceeded all of its other activities. It was held not exempt under section 501(c) (4) of the Code as its social welfare programs were not its primary activity.

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Name of Taxpayer ORG EIN		June 30, 20XX and June 30, 20XX

TAXPAYER'S POSITION

The taxpayer is protesting revocation of its exempt status. The organization requests to be reclassified as a 501(c) (4).

The second argument the taxpayer raised is that the Service should have included the gross receipts of the national fraternity in the calculation of the % / % test.

The third argument the taxpayer raised is that the Service consider the facts and circumstances test per IRM 4.76.16.6(d).

The fourth argument raised by the taxpayer is that charitable bingo is not considered an unrelated trade or business, first under the general exception of Internal Revenue Code 513(a)(1) where "substantially all the work in carrying on such trade or business is performed by the organization without compensation" and second under the express exception of Internal Revenue Code 513(f) that "[t]he term 'unrelated trade or business' does not include any trade or business which consists of conducting bingo games." Section 513(f) goes on and defines bingo games to mean:

"The term 'bingo game' means any game of bingo - -

(A) of a type in which usually - -

- (i) the wagers are placed,
- (ii) the winners are determined, and
- (iii) the distribution of prizes or other property is made, in the presence of all persons placing wagers in such game,"

and then Treasury Regulation Section 1.513-5(d) in 1969 added:

"A bingo game is a game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the game. As used in this section, the term *bingo game* means any game of bingo of the type described above in which wagers are placed, winners are determined, and prizes or other property is distributed in the presence of all persons placing wagers in that game. The term *bingo game* does not refer to any game of chance (including, but not limited to, keno games, dice games, card games, and lotteries) other than the type of game described in this paragraph."

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Name of Taxpayer ORG EIN		June 30, 20XX and June 30, 20XX

GOVERNMENT'S POSITION

Issue 1. ORG has not established that it operates exclusively for exempt purposes listed in Treas. Reg. § 1.501(c)(7)-1.

An organization described in I.R.C. § 501(c)(7) carries out activities in furtherance of its exempt purposes only when such activities are carried out exclusively in furtherance of the purposes listed in Treas. Reg. § 1.501(c)(7)-1. IRC § 501(c)(7) states that these clubs are organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder. If a club makes its facilities available to the general public to a substantial degree, and/or a significant amount of the organization's income is received from the general public, the organization may lose its tax exemption. ORG is involved in the following activities: quarterly meetings, a crawfish boil, homecoming event, and a formal dinner party/dance where the officers are elected; and the Festival; room rent for the house, and charitable bingo. The State of State's laws concerning charitable bingo states that the members of the exempt organizations can conduct the activity but they cannot participate in the activity. They can participate in the activity only when the bingo activity is being conducted by another exempt organization. As a result of our examination of Form 990 for the period ending June 30, 20XX, and June 30, 20XX, we have determined that the income amounts received from the bingo games are not an exempt activity.

Under *The Minnequa University v. Commissioner*, where outside income is both substantial and recurring, the statutory requirements are obviously not met and loss of tax-exempt status must result. This is consistent with the findings of this examination. Because ORG's non-member income is substantial in relation to its other income in all years under examination and recurs in each of the years, ORG must lose its exemption under Section 501(c)(7) of the Internal Revenue Code.

Issue 2. Whether ORG's gross receipts received from charitable bingo exceeds the % limit for Internal Revenue Code 501(c)(7)?

Public Law 94-568 specifies that an organization exempt under Section 501(c)(7) may not have more than % of income from non-member sources. ORG fails the test for the year ending June 30, 20XX where its non-member percentage of total income was %. ORG fails the test for the year ending June 30, 20XX where its non-member percentage of total income was %. Because the non-member income for ORG consistently exceeded the % limitation, ORG is no longer eligible for exemption under IRC Sections 501(a) and 501(c)(7) of the Internal Revenue Code and said exemption should be revoked.

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The following chart shows the amount of bingo income vs. member income for Fiscal Year Ending June 30, 20XX and June 30, 20XX:

FISCAL YEAR ENDING JUNE 30, 20XX				
NON MEMBER ACTIVITIES	MEMBER ACTIVITIES		MEMBER VS NON-MEMBER PERCENTAGES	
INCOME	FESTIVAL INCOME	ROOM RENT	% NON MEMBER INCOME	MEMBER INCOME

FISCAL YEAR ENDING JUNE 30, 20XX				
NON MEMBER ACTIVITIES	MEMBER ACTIVITIES		MEMBER VS NON-MEMBER PERCENTAGES	
INCOME	FESTIVAL INCOME	ROOM RENT	% NON MEMBER INCOME	% MEMBER INCOME

CONCLUSION

ORG no longer qualifies for exemption under Section 501(c) (7) of the Internal Revenue Code, as non-member income consistently exceeded the 15 percent limitation of total income, in the two years under examination. Nonmember income sources consisted of the following activities with the general public: charitable gaming, sales of ink markers, and sales of food and drinks. Hence, revocation of ORG's exemption is proposed effective July 1, 20XX.

The first argument proposed by the taxpayer is to be reclassified as a 501(c) (4) exempt organization. The organization is exempt under a group ruling, , and cannot be reclassified to 501(c) (4) unless the parent has a 501(c) (4) exemption.

Additionally, the taxpayer does not qualify for exemption under section 501(c) (4) of the Code because it has been established that the taxpayer is not primarily engaged in social welfare activities within the meaning of the statute. The activities that have been confirmed are the quarterly meetings, a crawfish boil, homecoming event, and a formal dinner party/dance where

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the officers are elected, and the Festival. These activities do not qualify as social welfare activities.

The second argument proposed by the taxpayer is that the gross receipts should have been included in the gross receipts of the national fraternity for the calculation of the %/% test. The IRM 4.75.24(1) states, "A group return is filed by the central organization on behalf its subordinates who are covered by a group exemption letter. The filing of a group return shall be in lieu of the filing of separate information returns for each subordinate included in the return." This would be applicable if the subordinate agreed to be included in the national organization's return, however, the subordinate chose to file separately, therefore this criteria does not apply.

The third argument proposed by the taxpayer is that the Service considers the facts and circumstances test per IRM 4.76.16.6.3.1(12). Apply the facts and circumstances test in cases where outside income exceed the % or % limitations. The factors to be considered in applying this test include:

- The actual percentage of nonmember receipts and/or investment income.
- The frequency of nonmember use of club facilities.
- The number of years the percentage has been exceeded.

Note: A high percentage of nonmember income in one year should be viewed more favorably than a pattern of consistently exceeding the limits. For example, a high percentage of nonmember receipts in 3 consecutive years is more likely to indicate the existence of a nonexempt purpose than the receipt of a high percentage of nonmember receipts in 1 year out of 3 years.

The charitable bingo games are open to the public and are not open for use by the members only. According to Revenue Ruling 69-68, 1969-1 CB 153, (Jan. 01, 1969); the fact that a club derives a principal part of its revenue from its recreational facilities does not affect its exempt status, so long as the facilities are used **only by the members and their guests**. The income from the charitable bingo games and the number of people that participate in these games has exceeded the number of members in ORG consistently for two years. The bingo is not a one time event, and, therefore, the facts and circumstances test cannot be applied in this instance.

The fourth argument proposed by the taxpayer is that bingo should not be considered an unrelated trade or business according to Internal Revenue Code 513(f). This is true for regular bingo where wagers are being placed, and bingo cards are being used. Treasury Regulation § 1.513-5(d) defines a bingo game as "a game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the

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game. As used in this section, the term "bingo game" means any game of bingo of the type described above in which wagers are placed, winners are determined, and prizes or other property is distributed in the presence of all persons placing wagers in that game. The term "bingo game" does not refer to any game of chance.

While the electronic video bingo machines are permitted in the state of State, the operation of the machines differ from the definition. During a tour of the bingo hall, CO-1, the agent noted that the electronic video bingo machines are in a separate room from the main bingo area. The room houses approximately 25 — 30 machines. At first glance, the machines resemble slot machines or video poker machines (usually found in casinos). Upon further inspection, the machines contain a bingo card in the top left corner. Numbered bingo balls are selected each time a patron presses the "Spin Reels" or "Play" button. The number of "bingo balls" changes with each press of the play button. Meaning that on your first spin 20 bingo balls were selected; however, on the next spin 15 bingo balls may be selected (not in addition to the first 20 bingo balls). Additionally, the numbers (i.e. B15 or 075) change on each spin as well as the "dauber" marks on the card. The machine pays out for each winning pay line on the reels or if a winning bingo pattern is made.

Based on the above information, revocation is being proposed. If revocation is upheld, effective July 1, 20XX, ORG will be responsible for filing Forms 1120. (See Exhibit 2 for the direct income and expenses.)

ALTERNATIVE ISSUE

If it is determined that ORG qualifies for exemption under section 501(c)(7), should the income from the bingo activities with the general public, sales of ink markers, and food and drinks to the general public be taxable as unrelated business income under section 511 of the Code?

FACTS

The ORG of ORG was established as a professional engineering organization in City, State. The organization is exempt under IRC § 501(c) (7). The organization is currently a social collegiate organization. The organization was founded at CO-2 in 19XX.

The members of ORG conduct bingo games at the CO-1 in City, State. The CO-1 is an unrelated for-profit organization. The State of State allows nonprofit organizations to rent a portion of the facility for conducting charitable bingo. According to the gaming laws for State, exempt organizations are required to participate in 15 sessions

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per month at a minimum. ORG began participating in the charitable bingo on October 1, 20XX. The bingo hall operates the following games: regular/traditional bingo and electronic video bingo. Members of ORG conducted the charitable gaming activities with the general public.

The Office of Charitable Gaming, which governs all charitable gaming activities in State, defines electronic video bingo as "a machine designed for the specific purpose of playing the game of bingo that has an electronic random-number generator to select numbers in lieu of the drawing of numbers from a receptacle and that one or more video images containing numbers or other designations five or more in one line may be utilized instead of a card" (per OCG's website). These machines print tickets that are redeemed for cash at the cashier's booth. Chapters 18 and 19 of the State Administrative Code outline the operation and use of electronic video bingo machines.

While this type of device is permitted in the state of State, the operation of the device differs from the definition. During a tour of the bingo hall, CO-1, the agent noted that the electronic video bingo machines are in a separate room from the main bingo area. The room houses approximately 25 — 30 machines. At first glance, the machines resemble slot machines or video poker machines (usually found in casinos). Upon further inspection, the machines contain a bingo card in the top left corner. Numbered bingo balls are selected each time a patron presses the "Spin Reels" or "Play" button. The number of "bingo balls" changes with each press of the play button. Meaning that on your first spin 20 bingo balls were selected; however, on the next spin 15 bingo balls may be selected (not in addition to the first 20 bingo balls). Additionally, the numbers (i.e. B15 or 075) change on each spin as well as the "dauber" marks on the card. The machine pays out for each winning pay line on the reels or if a winning bingo pattern is made.

ORG received income from both sources during the years under examination. (See Exhibit 2.)

LAW

Internal Revenue Code section 511(a)(1) imposes a tax on unrelated business taxable income on income received by an organization described in section 501(c), from an unrelated trade or business activity.

Internal Revenue Code section 512(a)(1) defines unrelated business taxable income as the gross income from any unrelated trade or business, regularly carried on by an organization, less the allowable deductions that are directly connected with the carrying on of such trade or business.

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Internal Revenue Code section 512(a) (3) (A) defines unrelated business taxable income for social clubs as all gross income that is not exempt function income. Furthermore, it provides that the unrelated taxable income of an organization described in section 501(c)(7) means the gross income (excluding any exempt function income), less the deductions allowed by Chapter 1 of the Code which are directly connected with the production of the gross income (excluding exempt function income).

Treasury Regulation §1.501(c)(7)-1(b) provides "A club which engages in business, such as making its social and recreational facilities available to the general public...is not organized and operated exclusively for pleasure, recreation, and other non-profitable purposes, and is not exempt under section 501(a)...."

Internal Revenue Code section 513(a) defines an unrelated trade or business as "any trade or business, the conduct of which is not substantially related to the exercise or performance by such organization of its charitable, educational, or other purpose" that is the basis for its exemption.

IRC §513(f) defines certain bingo games as not meeting the definition of an unrelated trade or business. Certain bingo games include any games of bingo, where a wager is placed, and a winner is determined, and a distribution of a prize is made in the presence of all persons placing a wager.

Treasury Regulation §1.513-5(d) defines a bingo game as "a game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the game. As used in this section, the term "bingo game" means any game of bingo of the type described above in which wagers are placed, winners are determined, and prizes or other property is distributed in the presence of all persons placing wagers in that game. The term "bingo game" does not refer to any game of chance (including, but not limited to, keno games, dice games, card games, and lotteries) other than the type of game described in this paragraph."

Treasury Regulation §1.513-1(d) (1) states that income is derived from an unrelated trade or business "if the conduct of the trade or business which produces the income is not substantially related to the purposes for which exemption is granted". This requires a relationship between the business activity and the accomplishment of the organization's exempt purpose.

Treasury Regulation §1.513-1(d)(2) provides that a trade or business is "related" to the organization's exempt purpose if the conduct of the business activity has a causal relationship to the achievement of the exempt purpose. When the business activity does not contribute

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importantly to the accomplishment of the organization's exempt purpose, the activity is not considered a related trade or business.

In *Julius M Israel Lodge of B 'Nai B'rith No. 2113 v. Commissioner* (98 F.3d 190), the court held that instant bingo games do not qualify for the "bingo game" exception to the unrelated business taxable income provision of 26 U.S.C. § 511. The court found that instant bingo games do not meet the preliminary requirement in IRC §513(f), but that instant bingo is, "for all practical purposes, a lottery." The court established that "winners in the Instant Bingo games are determined at the time the deck of cards is manufactured, and thus the winners are already predetermined outside the presence of *any* persons placing wagers in such game."

GOVERNMENT'S POSITION

ORG is licensed with the State of State to conduct charitable bingo activities. Members of ORG conducted the charitable gaming activities with the general public. When ORG conducted the charitable gaming activities with the general public, ORG violated Section 1.501(c) (7)-1(b) of the Regulations.

The income of \$ for the fiscal year ending June 30, 20XX; and the income of \$ for the fiscal year ending June 30, 20XX for charitable bingo is not exempt function income. Video bingo does not meet the definition of traditional bingo as defined in Treasury Regulation §1.513- 5(d), and is therefore unrelated business income and taxable under IRC Section 511 of the Internal Revenue Code. While traditional bingo does meet the definition, because all of the bingo is open to the public and is considered non-member income that makes the income subject to unrelated business income and taxable under IRC Section 511 of the Internal Revenue Code.

ORG sold drinks, food, and ink markers to the general public during charitable gaming activities. Since the State of State doesn't allow the members to participate in the bingo games on the nights that their particular organization is running the session, all of the sales are deemed to be from non-members and are by definition unrelated business income.

TAXPAYER'S POSITION

Taxpayer's position is unknown at this time. However, the results of the examination have been discussed with the organization's representative.

CONCLUSION

ORG is liable for unrelated business income on the charitable bingo activities conducted with the general public.

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ORG is liable for filing Form 990-T for fiscal years ending June 30, 20XX, and June 30, 20XX.

After calculating the amount of tax that would be due for the video bingo income, the results are represented on Form 4549 attached.

ORG OF ORG

INCOME

	Income	Video Income	Income for Supplies	Cost of Prizes	Adjusted Gross Proceeds
July 1, 20XX to September 30, 20XX - No income.					
Oct 20XX to Dec 20XX					
Jan 20XX to Mar 20XX					
April 20XX to June 20XX					
TOTALS FOR FYE 6/30/20XX					
July 20XX to Sept 20XX					
Oct 20XX to Dec 20XX					
Jan 20XX to March 20XX					
April 20XX to June 20XX					
TOTALS FOR FYE 6/30/20XX					

ORG OF ORG

INCOME

	Income	Video Income	Income for Supplies	Cost of Prizes	Adjusted Gross Proceeds
July 1, 20XX to September 30, 20XX - No income.					
Oct 20XX to Dec 20XX					
Jan 20XX to Mar 20XX					
April 20XX to June 20XX					
TOTALS FOR FYE 6/30/20XX					
July 20XX to Sept 20XX					
Oct 20XX to Dec 20XX					
Jan 20XX to March 20XX					
April 20XX to June 20XX					
TOTALS FOR FYE 6/30/20XX					

ORG OF ORG

INCOME

	Income	Video Income	Income for Supplies	Cost of Prizes	Adjusted Gross Proceeds
July 1, 20XX to September 30, 20XX - No income.					
Oct 20XX to Dec 20XX					
Jan 20XX to Mar 20XX					
April 20XX to June 20XX					
TOTALS FOR FYE 6/30/20XX					
July 20XX to Sept 20XX					
Oct 20XX to Dec 20XX					
Jan 20XX to March 20XX					
April 20XX to June 20XX					
TOTALS FOR FYE 6/30/20XX					

FISCAL YEAR ENDING JUNE 30, 20XX			
INCOME		Member Income for Room Rent	Festival Income
Traditional			
Video			
Income for Supplies			
TOTAL INCOME			
EXPENSES			
	EXPENSES	MEMBER RELATED EXPENSES	
Prizes			
Gaming Supplies			
Accounting Fees			
Payroll for			
Bank Charges			
Hot Hat Rental			
Refreshments			
Licenses			
Total	Related Expenses		
Room Rent			
Depreciation			
Supplies			
Member Recruitment			
Chapter Expenses/Insurance/Activity Related			
Interest Expense			
Conferences, conventions, & meetings			
Postage & Shipping			
Printing & publications			
Festival			
ORG Foundation			
Charitable Contributions			
Total Member Related Costs			